2 From Basel III to Basel IV?

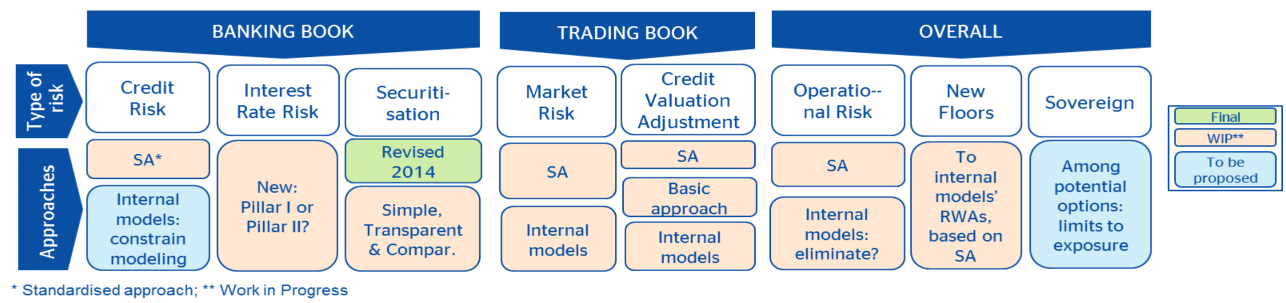
Comprehensive ongoing review of Risk Weighted Assets

The BCBS is currently undertaking an ambitious revision of RWAs (denominator of capital ratios) that could impact significantly on both minimum capital requirements and disclosed capital ratios. The new global rules are due to be completed by end-2016 and expected to come into effect in 2019.

After the adoption of the Basel III risk-based capital ratios in all 24 FSB jurisdictions, and with all internationally active banks already meeting the fully phased-in capital requirements, bank solvency has been considerably strengthened in recent years.

When Basel III saw the light of day in 2010 it was recognised that the framework was not definitive regarding the RWAs of some exposures (e.g. securitisation and trading book) and a revision was envisaged for a later stage to improve risk-sensitivity, reduce reliance on credit ratings and prevent regulatory arbitrage. But subsequently the review of Basel III has gone much further than was initially intended, extending its scope to include practically any type of risk and any approach used to calculate RWAs. A second wave of revisions is associated with BCBS's strategic review of the risk-weighted capital framework to assess whether it strikes the right balance in terms of simplicity, comparability and risk sensitivity. This was a reaction to the questioning of the capital framework on the grounds of its excessive complexity and lack of comparability, particularly when internal models are used. Following this and with the aim of addressing the excessive variability in RWAs observed across institutions, the BCBS set out a multifaceted plan to the G20 in 2014 and during 2015 has made substantial progress towards finalising the new rules. A report to the G20 in November 2015 revealed the intention to complete the revision by end-2016.

Figure 2.1
Revisions to Basel III framework with potential future impact on RWAs



Source: BBVA Research

The impact of these revisions is difficult to assess in advance due to the fact that it is on top of that derived from the Basel III framework, implemented in 2014 and subject to phase-in provisions until 2019. In addition, the cumulative impact is difficult to assess, given the multiplicity of changes being introduced at the same time. Despite global regulators' declaration of no intention to significantly increase overall capital requirements, which reflects the growing awareness that the objective of financial stability should be combined with the goal of not impeding economic growth, the industry is greatly concerned about the potential additional tightening of capital requirements due to the conservative bias in the calibration of the proposals so far published. Furthermore, even if at a global level the impact were neutral, it would not prevent entities from having a significant impact at a credit entity or business line level. To conclude, a significant change in solvency standards is underway; discussion on whether we call it 'Basel IV' or 'revised Basel III' should not overshadow what is really important, which is its impact on the financing capacity to sustain growth. This is particularly relevant in the case of Europe given the importance of the banking sector in financing the economy.

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